RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 • REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION
POST OFFICE BOX 1759, LA JOLLA, CALIFORNIA 92038
26 LETTERS PER YEAR • $225 ANNUALLY

November 15, 1984 **LETTER 900**

Nov. 2, DJIA 1216.65; PTI 1618; A-D Ratio -- 19.80
Nov. 9, DJIA 1218; PTI 1624; A–D Ratio –19.39

THE PICTURE: Let's get down to brass tacks. Reagan won in a huge popular and electoral sweep. It was a massive vote for the Reagan personality and the Reagan all-American character. Many newspapers headlined it a "mandate" for the President. Don't you believe it! For the nation, it would have been better if Reagan had not done as well in the electoral or popular vote – but had done better in Congress. The fact is that the Republicans (although they still have a majority in the Senate) lost two seats. As for the House, the Republicans not only do not control it, they are worse off now than they were during the first two years of the Reagan reign.

But the Reagan victory was a repudiation of the Democratic party's ancient tax, spend and redistribute policies, and it was the nation's way of saying that Mondale's voice is a voice from the past (somewhere between 1932 and 1945). Interestingly, the Democrats lost large chunks of the white vote, the Catholic vote, the young vote, the Latino vote, the Asian vote and the Southern vote. Amazingly, one-third of the Democratic vote came from blacks.

What does it all mean? To me, it means that Reagan is going to have a HARD TIME getting anything done. The Democrats are already warning against raising taxes, and they'll probably fight any VAT tax. The Democrats will want defense cuts, hands off on entitlements, etc. One thing is sure. Whatever Reagan can get through, he will get through with big compromises. Veteran readers may remember Russell's political rule: "The politicians don't do anything until the problem hits the fan and the people scream. Then they do as little as it takes to bring the screams down to a mild noise."

Here's another item. I feel that whatever Reagan does, he's going to have to do FAST. The flush of his great personal victory will die out within six months. You don't believe it? This little chart from the WSJ shows what happens to two-term Presidents' popularity as the second term starts. It's not a happy thought.

Two-Term Presidents' Declining Popularity

Second-Term Approval (in percent)

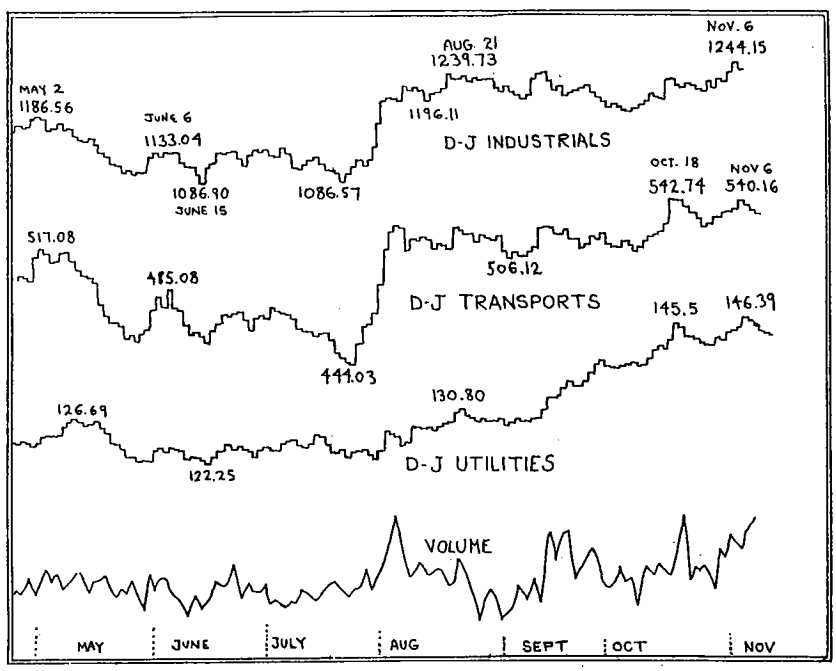
PRESIDENT	START OF 2nd TERM	ONE YEAR LATER	LOW POINT
	Jan. '49	**Jan. '50**	**Nov. '52**
Truman	69%	45%	23%
	Jan. '57	**Jan. '58**	**Mar. '58**
Eisenhower	73%	60%	48%
	Jan. '65	**Jan. '66**	**Aug. '68**
Johnson	71%	59%	35%
	Jan. '73	**Jan. '74**	**Aug. '74**
Nixon	51%	27%	24%

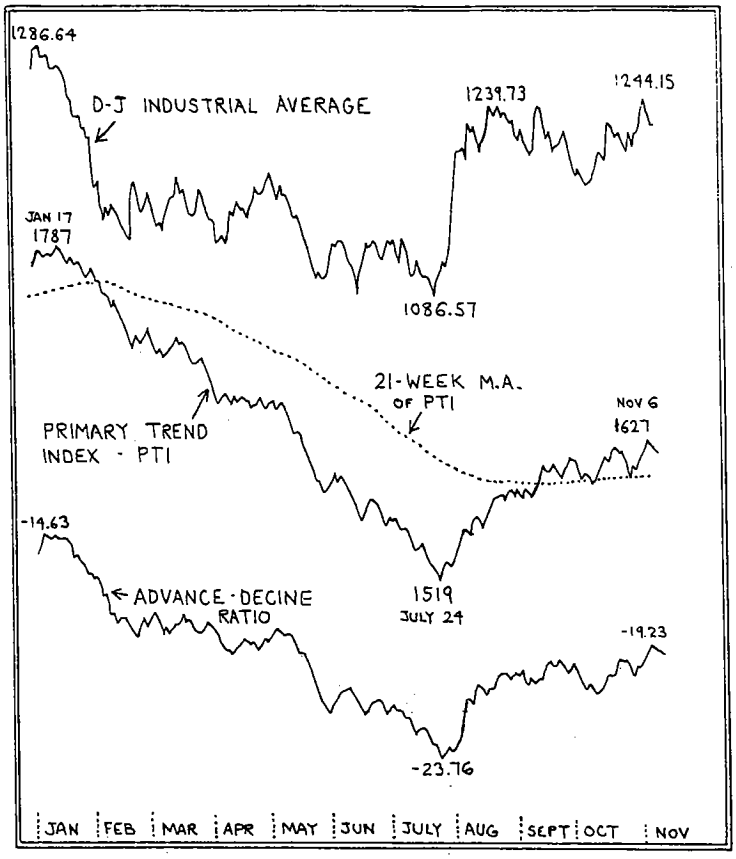
Next thought, and this pertains to both politics and the stock market. *Smart Money* (6 Deer Trail, Old Tappan, NJ 07675) did a study of landslide Presidential victories and their aftermath. The record is below. And the record shows that since 1900, whenever there was a landslide Presidential victory, the market has headed into trouble. The reason: landslide Presidents tend to tackle tough and often unpopular problems. So the market protects itself by backing off.

LANDSLIDES OF OVER 400 ELECTORAL VOTES SINCE 1900 AND EXTENT OF SUBSEQUENT BEAR MARKETS

WINNING CANDIDATE	Election Year	Electoral Votes	DOW JONES INDUSTRIALS Subsequent High	Subsequent Low	Extent of Decline
Woodrow Wilson (D)	1912	435	91.94 (11/12)	72.11 (6/13)	–21.6%
Warren G. Harding (R)	1920	404	85.48 (11/20)	63.90 (8/20)	–25.2
Herbert Hoover (R)	1928	444	381.17 (9/29)	41.22 (7/32)	–89.2
Franklin D. Roosevelt (D)	1932	472	68.04 (11/32)	50.16 (2/33)	–26.3
"	1936	523	194.40 (3/37)	98.95 (3/38)	–49.1
"	1940	449	138.12 (11/40)	92.92 (4/42)	–32.7
"	1944	432	No Decline		—
Dwight D. Eisenhower (R)	1952	442	293.79 (1/53)	262.88 (6/53)	–10.5
"	1956	457	520.77 (7/57)	419.79 (10/57)	–19.4
Lyndon B. Johnson (D)	1964	486	995.15 (2/66)	744.32 (10/66)	–25.2
Richard M. Nixon (R)	1972	520	1051.70 (1/73)	577.60 (12/74)	–45.1
Ronald Reagan (R)	1980	489	1024.05 (4/81)	776.92 (8/82)	–24.1
				AVG	–30.7%

And certainly Reagan has to face (he absolutely cannot avoid them) some very tough problems. Not the least of which is the off-the-wall, insane, nation-busting series of budget deficits. In a later section of this Letter I will go into a few aspects of the gathering budgetary nightmare.





But don't be shocked if the markets (all of them) start to react to the problems that confront the nation as budget deficits of near $200 billion a year stretch out as far as the eye can see.

What the stock market and bond markets are fearful of: A stalemate between Reagan and the Senate and House on any real solution to the deficits. The markets are also afraid that maybe NOTHING will be done, in which case we will be deep in Russell's rule country – the deficits will pile up until a whopping crisis FORCES action. As I have noted, the present Congressional set-up is not conducive to a real, fundamental solution to the budget problem.

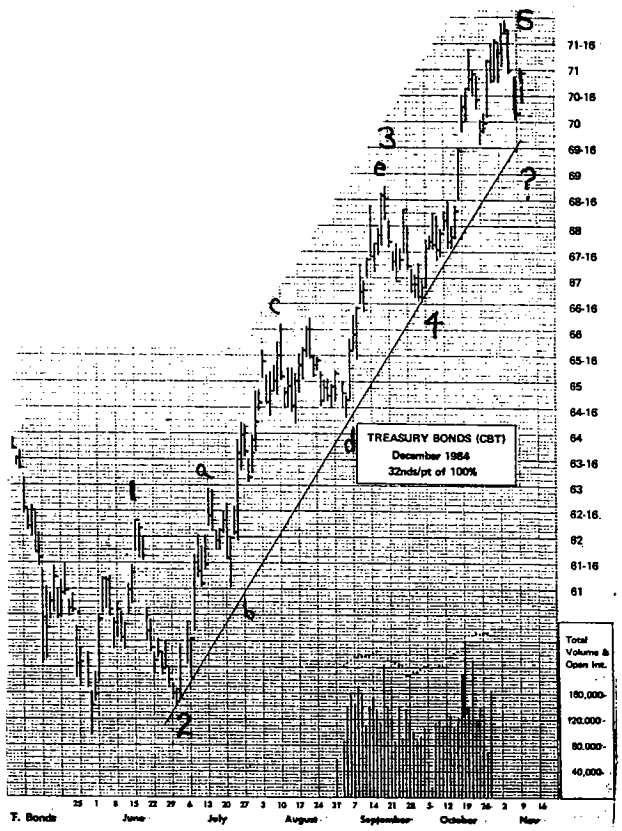
All right, now that I have that out of my system, let me tell you some of the items that I've focused on in the markets. (1) On November 5, the day before the election, the market put on a fairly positive performance. The Dow (which has been a laggard since August 21) rallied and finally closed above its August 21 high of 1239.73. The rise, however, was *not confirmed* by a new recovery high in the Transports. On the same day the D-J Utility Average closed at 146.39, its highest level since 1965 (which is pretty impressive). Again, on the same day the advance-decline ratio recorded a new high since August, and the A-D line for the most-active-stocks rose to a new high. My positive volume line (based on the advance/decline plurality on days when volume is up) hit a new high as did my on-balance-volume line for the NYSE.

(2) Let's turn to my own market barometer, the Primary Trend Index (PTI). Being on the right side of the PTI has saved me an awful lot of agony and an awful lot of money over the years. The fact is that the PTI is a lot smarter than I am. I've stated repeatedly that the beauty of the PTI is that you don't have to be a genius to read it – all you really have to know is up from down.

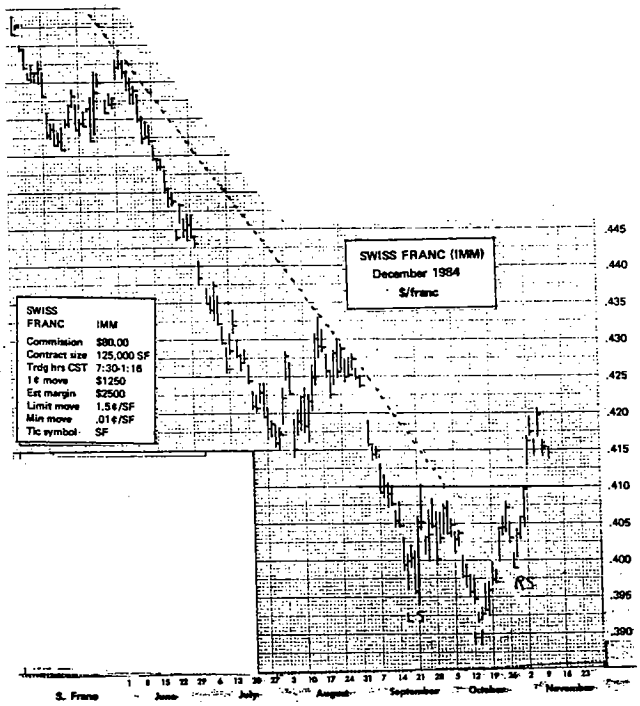
As you can see on the page 2 chart, the PTI has been testing 21-week moving average. It dips to touch the 21-week MA, then pops higher. On November 6 the PTI pushed to its highest level since the August bottom, and as this is written the trend of the PTI continues UP.

Since the August market low I've been worried, I've had white knuckles, I've been ready to run. But the message from the PTI has all along been, "Sit tight with stocks, the trend is bullish." The trend of the PTI (as long as it holds above its 21-week MA) is up. That's the story it's telling, so I guess I should relax and enjoy it.

(3) Subscribers have (I hope) been following my comments on the bond market. I've been bullish on bonds ever since Letter 889 (June 13). I bought bonds, and I know a lot of my subscribers did too. The bonds have made a BIG move, and they have been the most profitable area in the markets over the last five months. Now everyone is asking me, "Is the bond move over?" And I say, "I don't know, Henry Kaufman doesn't know, Fed Chairman Volcker doesn't know, nobody knows. And you know what – we don't have to know. The bonds have been walking up a beautiful trendline (see chart, page 2), and as long as they are fluctuating or climbing or even sinking ABOVE that trendline I'm happy, and I'm going to hold 'em. When the trendline is broken, we'll know the trend has turned. Not every item provides us with such a beautiful trendline, but the bonds did. So sit tight. We'll watch them. (Chart courtesy of Dunn & Hargitt).



(4) Here's another place I'm looking. My instinct tells me that the dollar could be topping out. Yes, I know, eager analysts have been predicting a topping out of the dollar during every week and every month of this year. But I'm seeing head-and-shoulders bottoms in a number of currencies (Mark, Swissie) and I'm seeing the currencies do something they haven't done in six months. They're breaking above their 10-week moving average lines.



What does it mean IF the currencies have bottomed and the dollar has topped out? It means a whole new ball game, and the ramifications are so many and complex that I could write about them for a week. A dollar top-out would mean fatter profits for those US corporations that have large overseas sales, it would mean problems for the US Treasury (foreigners own 15% of the entire US federal debt), it could help the US balance-of-payments, it could mean that the Fed would have to keep the pressure on interest rates so that it could sell dollar denominated bonds, and on and on. Oh yes, since oil is paid for in dollars it would help oil importing nations and hurt oil producing nations.

(5) I'm watching gold (as always). The first bull signal on gold, according to my work, would come on a London fix of 360. Silver, I'd want to see a spot price of 8.00 before I began to get excited about silver. At 8.00 I'd get my first silver bull signal.

(6) I've been writing about that head-and-shoulders bottom in the broad Value Line Composite. A Composite price of 185.5 would be very bullish for the entire stock market. But if the Value Line Composite comes down to 176.5, I'd say that the pattern is starting to break down, and that would be a dismal signal for the market.

INVESTMENT POSITION: The PTI is trending above its rising 21-week moving average, and that keeps the bull in this box. The rise in the PTI since September has been plodding, but November 7 saw a new PTI of 1627 confirmed by new recovery highs in the Dow and the A-D ratio. All of which means that we hold our common stocks and no-load stock funds.

As for bonds, I've been expecting a correction, but the bonds should be held as long as the December T-bond futures hover above the 69½ level. If 69½ goes, it might pay to take some profits. The bond rally has been profitable and spectacular. Municipal bonds would now seem to be on the bargain table compared with governments. Non-taxable high quality munis are offering yields which amount to 89% of Treasury yields on bonds of comparable maturity. For investors in high income brackets, that's picnic-time for muni buyers.

COMPOUNDING: The power of compounding is a phenomenon that I have brought to the attention of my subscribers over and over again. The surest way of getting rich is to compound safe, high-return securities over a long period of time. The surest way of going broke is to compound debt at high rates of interest over an extended period of time.

We are seeing outstanding examples of both in the US today. Many of my subscribers, taking heart from compounding tables that I include in these reports from time to time, have been compounding assets at rates of anywhere from 10% to 13% for the last five years. Needless to say, they have done very well.

I'm not going over the whole spectrum of compounding tables again, but to present one example: if you buy muni bonds at say an average yield of 10%, then over a period of ten years $10,000 is going to be roughly $26,000. At the end of the ten years that $26,000 is all yours – there are no taxes to pay. If you can save $10,000 each and every year and you place that money in muni bonds at an average yield of 10%, then at the end of ten years you will have $159,000. That $159,000 will be throwing off almost $16,000 in annual interest – all free from taxes. And that is how you get "rich" assuming, of course, that you have the patience and self-control to stay with the compounding approach.

Now just as compounding your assets can make you rich, compounding your debts and deficits can break you. Perhaps the greatest example of this is seen in the path being followed by your government and mine. Yes, I'm talking about the US government. I started issuing warnings about the government's finances in 1980 (actually, I had written about them much earlier, but 1980 was when I began my "heavy warnings," my warning to the effect that inflation was no longer the wonderful, painless way out of the debt predicament). When Jimmy Carter was elected I stated that he should immediately, the day he entered office, start an all-out offensive to balance the budget. I did the same thing when Ronald Reagan was elected. I wrote that nothing, NOTHING, was as important as an all-out campaign to bring about a balanced budget.

Obviously, neither of the Presidents listened to me. How do we know? It's in the record, and I present the record year-for-year here in this little tabulation. What we see here is a gathering horror story. It's the story of rising entitlements, rising defense budgets and rising interest costs on the federal budget.

Spiraling figures

U.S. deficits since 1974:

Fiscal year	Deficit
1974	$4.7 billion
1975	$45.2 billion
1976	$66.4 billion
1977	$44.9 billion
1978	$48.8 billion
1979	$27.7 billion
1980	$59.6 billion
1981	$57.9 billion
1982	$110.6 billion
1983	$195.4 billion
1984	$175.3 billion

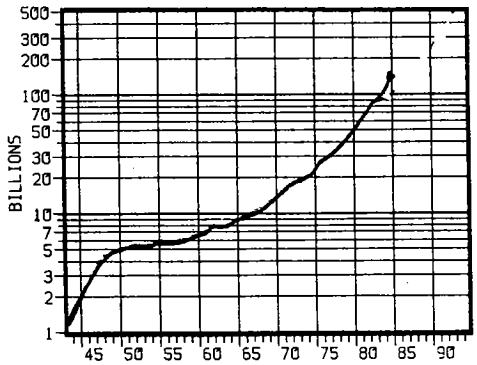
Source: U.S. Treasury Department

But now the real horror begins. It can be seen in this little page 4 chart (courtesy of Jim Blanchard's *Market Alert*).

To make things even more dramatic, I'm going to illustrate this piece with newspaper clips (page 4) all cut from the October 26 papers (which covered the latest figures on the federal budget).

Now note that the latest budget deficits occurred in the face of a whopping rise in corporate tax receipts – up 53.9% over 1983! That's not going to happen again this year in the new budget. Note that social welfare spending climbed 5.7% and defense spending climbed 7.7%. Note also that the national debt is pushing towards the $2 trillion mark.

ANNUAL FEDERAL INTEREST PAYMENTS



Corporate tax receipts soared 53.7 percent over 1983 to $56.9 billion, helped by the economic expansion.

The final report showed that government revenues totaled $666.4 billion in 1984, up 10.9 percent from 1983. Government spending totaled $841.8 billion, up 5.8 percent from 1983.

Defense spending rose 7.7 percent to $220.8 billion. That was less of an increase than the 10.7 percent jump to $227 billion that the administration had expected.

Social welfare spending went up 5.7 percent to $292.2 billion, also less than the 6.4 percent increase the admininstration estimated.

The 1984 report showed that the fastest growing category in the federal budget is interest payments on the national debt, which increased by 19.4 percent last year. The $153.8 billion in interest paid on the $1.6 trillion debt is the third-biggest spending category, ranking only behind the Department of Health and Human Services and the military.

The 1984 deficit brought the national debt to $1.59 trillion, representing the accumulation of deficits of all past years.

The Reagan administration years have added about one-third to the national debt, or $539.2 billion for the biggest four-year increase by far.

The deficits during the Carter administration totaled $181 billion and were $144 billion during the Ford years.

It marked the 15th year in a row that the government operated in the red and the 43rd in the last 50 years.

But here is the dramatic part – the kicker that I have been warning about. The fastest growing category of the federal budget is the COST OF INTEREST. Note that the federal government spent $666.4 billion in 1984, up 10.9% from 1983. But interest costs on the federal debts rose 19.4 % to $153.8 billion. In other words, and note this carefully, interest costs on the federal debt are now 23% of the whole federal take! To put it another way, almost one out of every four dollars the government takes in now goes to cover interest on the federal debt.

You want to know how this interest cost has progressed? Glance over these figures. In 1972 interest costs took 10% of all federal revenues. By 1975 interest costs burned up 11.5% of all revenue. In 1980 interest costs rose to 12.5% of the entire federal revenue take. And here in1984 the cost of interest is a new high of 23.1% of all government revenue. If the current trend continues, by 1986 interest costs will eat up roughly 30% of all federal revenue.

This whole situation is now moving into what I term the ominous stage. For the fact is that compounding interest on the federal debt is now starting to eat this nation up alive.

Question: What do you see coming up? I mean, how can this whole thing be resolved?

Answer: I've said this before, but here goes again. We've spent money we don't have–probably as far as three or four generations ahead. We've spent a good deal of our future. Everybody seems to realize that there are no free lunches. So how do we apply that to what's happened? I apply it this way: the US standard of living is on a downward path. We've spent our future; we've had the good life BEFORE we earned it. And the long-term rise in interest rates is telling me that "pay off time" is drawing ever closer.

The government can try to inflate us out of this mess. But my opinion is that if the government attempts to inflate us out of the interest rate burden, then the bond markets (fearing inflation) will collapse, bringing about new highs in interest rates and sending the economy into a tailspin. How the government can inflate with business collapsing I don't know–maybe some of the inflationists can explain this to me.

The other path is to move towards higher taxes, lower spending or both–all in an effort to contain the deficits. But even here I am afraid that the problem is massive. If the government cuts spending significantly, we move into recession. If we move into recession the government's corporate tax take declines and the deficit moves still higher. On the other hand, if taxes are raised then that much more money is taken out of the civilian and corporate spending coffers–and that in turn hits the economy.

In my opinion, there is no PAINLESS way out of the mess the US government is now in. And remember, this has all occurred with a super-strong dollar bringing money into this country. What happens if the dollar turns weak and money starts flowing OUT of the country?

Any way you look at it, we are heading into the pain. One pain would entail a lowered standard of living via inflation (or the attempt at inflation). The other variety of pain would entail loss of purchasing power via loss of jobs, loss of assets and loss of buying power due to deflation (during deflation salaries tend to go down).

The biggest question about the whole situation, to my mind, is the timing of the trouble. Right now the government and the Fed are holding off the day of reckoning with soothing words and a juggling act (on the part of the Fed). But every day, every week, every month the cost of interest on the Federal debt continues to rise. That cost is now $3 billion A WEEK. This unbelievable amount will act like a sponge, sopping up money as fast as it is available. And as the cost of interest assumes a larger and larger portion of the total government tax take, the government will find it harder and harder to finance what it has already contracted to do.

Thus, as the crisis mounts the government will have to either renege or re-negotiate its debts, or cut back drastically on entitlements and on defense. The one SURE thing is that the laws of mathematics will continue to operate–and the debts and deficits will continue to compound.

Coincidentally, after writing this piece I noted an article in the New York Times by long-time economic writer Leonard Silk. The piece is entitled, "Is a Recession Coming in '85?" I include the opening paragraph from the Silk article:

THE huge budget deficit threatens to paralyze fiscal policy after the election, no matter who is elected. A recession could cause the deficit to soar to $300 billion to $400 billion; a deficit of such size would inhibit fiscal action to combat the recession by increasing spending or cutting taxes further. And fear of recession may prevent the White House and Congress from acting decisively to cut the budget deficit.

A steep United States recession would have dangerous implications internationally. It would cause a slowdown or reversal in foreign investment in this country, due to the combination of falling profits here and a falling dollar. The shrinking of capi-

tal flows would mean a shortage of funds to finance both the United States budget deficit, the trade deficit and private investment in new plant and equipment. The shortfall of savings from abroad would keep real interest rates high.

Though the falling dollar would ease the American trade deficit, now running at a record annual rate of $130 billion, it would cause a drop in foreign exports and aggravate the problems of debt-ridden developing countries — and hence the problems of American banks.

Question: Russell, what do you see for taxes in the years ahead?

Answer: The Reagan thesis that growth will take care of the deficits is an idle dream. Growth may diminish deficits, but when the deficits are coming in at the rate of $200 billion a year, growth just isn't going to do it.

One fascinating fact is that the top 10% of US taxpayers account for 50% of the entire tax take. While the bottom 50% account for only 10% of the tax take. So you can see that the better-off and rich are really paying through the nose.

My guess is that Reagan would like some kind of flat tax with a value-added tax on top of that. But the value added tax would be the big kicker, and such a tax could raise $100 billion or more.

Rep. Barber Conable (retiring top-ranking Republican on the House Ways and Means Committee) had some wise words to say about taxes in a recent interview with a Washington Post staff writer:

There is strong interest in simplifying the tax system by "flattening" it—reducing the number of brackets and cutting the top tax rates, thus narrowing the gap between highest and lowest rates.

"The effect of flat taxes tends to be to reduce taxes significantly for the wealthy and raise them slightly for everybody who isn't wealthy to make up for it," Conable said. "Now, they [flat tax advocates] have tried to jiggle them this way and that, creating exclusions and modest graduations and so forth, and maybe they've been able to do that."

When Congress gets into the act, "they're very likely to jiggle it even further to be responsive to pressure . . . so you're likely to wind up reducing taxes significantly for the wealthy and raising them slightly for everybody else," he said. "Therefore, even with a revenue neutral bill, you're raising taxes for more people than you cut them for. Now, when you start at the bottom of a $200 billion dollar fiscal hole, how much worse it gets."

One idea proposed by tax lobbyist Charls Walker would be to combine tax simplification with a value-added tax—a form of national sales tax that would raise new revenues.

"He assumes it will be easy to pass a simple value added tax. Well, that's a lot of baloney too," Conable said. "You can't pass a simple value added tax, which is basically a regressive vehicle, in a political group like the Congress. They're going to try to make a basically regressive vehicle less regressive by having a different rate for luxuries and necessities, by having exclusions for poor people and credits against other taxes, and in the process you're going to give away a lot of the revenue you could get."

Besides, Conable said, the proposal adds up to "a double whammy and regressivity for the average American" who would suffer from both a flattening of tax rates and the regressive nature of the VAT, he said.

NOTES AND QUOTES: For the first time in four years the big Lesser-Developed Countries are moving out their exports as rapidly as they are increasing their debts. This has caused some experts to feel that the "debt crisis" is over. At worst, it seems the crisis is simmering down.

* *

Electronics and computers have changed the face of the world financial scene. Exchange controls are now all but dead, and billions in various currencies change hands every hour. This has resulted in a phenomenon I have been predicting for years–and that is that THE POWER HAS TRANSFERRED FROM THE GOVERNMENTS TO THE MARKETS. When the markets talk (and I'm not talking about E. F. Hutton), governments listen. The US government is no different. Watch what happens if oil prices sag, or interest rates pop, or gold starts to climb!

* *

Euromoney magazine (current issue) rated the top economic performances for the 1974-83 period country by country. Tops were (1) Singapore, (2) Taiwan, (3) Malaysia, (4) Hong Kong, (5) Saudi Arabia. The US was 26th on the list. The worst were (89) Zaire, (90) Ghana, (91) Bolivia, (92) Israel, (93) Argentina. The risk ratings were different. The best risks (all ranking 100) were USA, West Germany, Japan, UK, Switzerland, Australia, Canada, Sweden, Finland.

* *

Defense: Don't ask me how they are going to pay for it. But I can tell you that the new Strategic Defense "department" has been formed under Lieut. Gen. James A. Abrahamson. Currently, a five-year research program is in place, and the cost of the research is estimated at around $30 billion. But that's just the research. The cost of the total program (although no one knows for certain) is estimated at anywhere from $400 billion to near one trillion dollars.

Meanwhile, many politicians (including Mr. Mondale) debate the wisdom of heading into an anti-missile program of the kind outlined in the Strategic Defense Initiative. To my mind, such arguments are absurd unless we want to cede the world to the Russians. Does anyone doubt that the Russians aren't going full steam into an anti-ABM program?

The study by the council was based on the Defense Department's current five year $24.2 billion research program and on experience with the National Aeronautics and Space Administration's Apollo program and other large projects. The study arrived at an estimate of $400 billion to $800 billion for the plan.

Reliable Estimate Impossible

But the council also acknowledged: "It is impossible to make a reliable estimate of the full procurement cost of a strategic defense system given uncertainty about the technologies involved."

On the other side, General Abrahamson acknowledged the program would be expensive, but said determining the cost was among the objectives of the research program, officially known as the Strategic Defense Initiative.

* *

The tax court has ruled that watching the ticker tape does not enhance trading profits. They disallowed a tax deduction from an investor who claimed he had to drive to and from his brokerage office in order to monitor his investments.

* *

Best performing mutual funds over the last year: (1) Mutual Shares and Mutual Qualified Shares–both up over 15%.

* *

With state after state offering lotteries, I should inform you that the surest way of making money in lotteries is to sell the tickets. The lottery agents make about 5 to 6% on ticket sales and the franchises are hot. According to Money magazine, one newstand in Gotham's World Trade Center averages $1,000 per day in lottery commissions.

* *

An important new book entitled "Survival is Not Enough" was reviewed Nov. 1 in the WSJ. The book was written by Prof. Richard Pipes, a longtime observer of Russia and a Harvard professor. Pipe's argument is that the Russians understand or respect power and only power. He feels that our mere reacting

to Russian power plays is not enough. I include below cogent paragraphs from the WSJ review (review by Amos Perlmutter, editor of the Journal of Strategic Studies).

> Mr. Pipes stresses the link between the Soviet system of government and Soviet strategy; his contention throughout this book is that the Soviet policy of militarism and foreign expansionism stems directly from domestic sources and potential domestic troubles.
>
> The author gives a cohesive and devastating analysis of the Soviet system and its power elite, known inside Russia as the *Nomenklatura*. The Nomenklatura is the Soviet Union's invisible aristocracy-bureaucracy, which dominates the state and the Russian empire. In effect, it acts as a kind of double bureaucracy, since much of the elite's effort consists in its members checking up on one another rather than in carrying out the responsibility of running the state.
>
> Not surprisingly, Mr. Pipes draws a portrait of a corrupt party whose members enjoy an elevated and rich life style far removed from that of average citizens—a life style that is jealously guarded. The result is growing unrest, growing dissent, an inefficient economic system, an agricultural system that is a continued disaster and a party that has its fingers in running everything from automobile factories to secondhand bookstores.
>
> Obviously, this amounts to a bureaucratic as well as an economic domestic crisis, and it is precisely this state of affairs, institutionalized and ongoing, that precipitates Soviet expansionism.
>
> Building on this analysis, Mr. Pipes takes pokes at Western liberals who see Soviet aggressiveness and militarism as a sign that the Soviets are "paranoid and fearful of the West." He argues that the Soviets' strategy is, in fact, a way of exploiting the weakness of the West in order to cover the Soviet ruling class's weakness.
>
> Soviet military buildups seek to enforce the principle that the West must accept Soviet strategy as a basis for East-West negotiations. In the Soviet Union, the armed forces are no longer merely an instrument of power, they are a part of the power structure. Soviet military doctrine is based on a simple axiom of the celebrated military strategist Clausewitz: The military's role in a war is to win it. For the Soviets, Mr. Pipes argues, nuclear weapons do not primarily serve the purposes of deterrence but "are the principal instrument of modern war." The Soviets have no aversion, moral or otherwise, to nuclear war, as long as they can win it.
>
> The author attacks those who believe that because of the enormous destructive power of nuclear weapons the West must accommodate itself to a Soviet strategy of aggression.

Statistics: You think new cars are the big sellers? In 1983 8 million new cars were sold while 17 million used cars were sold.

You think the US has the longest life expectancy? In the US life expectancy is 74 years. In the Netherlands, Sweden and Japan it is 76 and in Iceland it is 77. Lowest life expectancy is Afghanistan, Ethiopia and Chad at 40, Mali at 43, Cameroon at 47. Conclusion: you want to live long, live in Iceland, not Africa.

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Who are the guys who manage the money? Here are the US's biggest money managers. (1) Bankers Trust which manages $23.8 billion (2) J.P. Morgan with $22 billion. (3) Citicorp with $18 billion. (4) DLJ/Alliance Capital Management with $25.7 billion. (5) Collete Retirement Equities Fund with $14.6 billion. (6) Capital Group with $13.7 billion. (7) Marsh & McLennan with $12.1 billion, and (8) Mellon National with a mere $11.4 billion.

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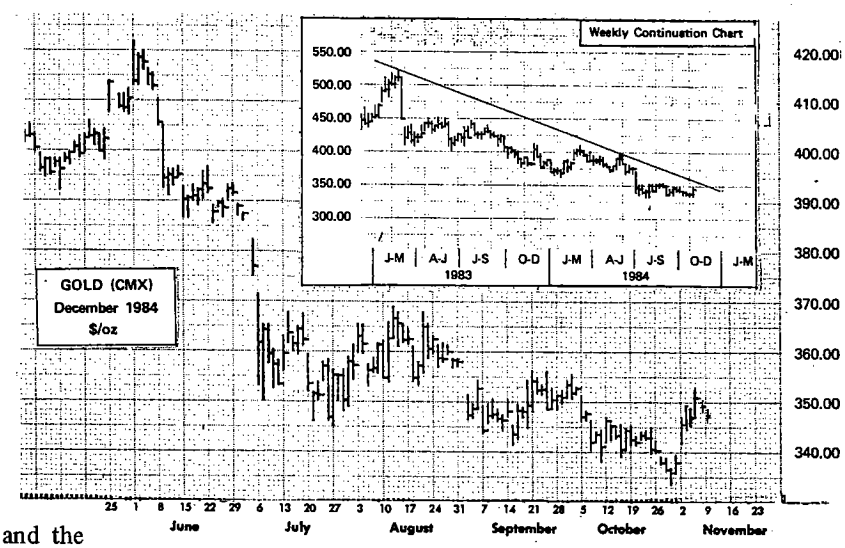
GOLD: Gold ran up sharply as the dollar weakened and the foreign currencies formed bases. The simplest rule of technical analysis is that when the price action moves above a previous peak, something good is happening. On that basis the December gold contract, as seen on this Dunn & Hargitt daily chart, would have to move up to 357 to be bullish. As you can see on the longer-term (weekly) inset chart, gold is still holding below a 2-year trendline. But spot gold at roughly 360 would reverse that trendline to the upside.

I can't prove it, but my feeling is that gold (let's pretend it has an intelligence of its own) is looking ahead at the US deficit picture. And what it sees are massive deficits reaching out to the horizon. On that basis, interest rates are not going to collapse (despite the predictions of some optimistic economists), and inflation is not going to heat up to the point where frightened investors rush into precious metals.

Let me put it another way. The deficit problem must be solved or this nation is going to devour itself in compounding debt. BUT, I don't see any way that the deficit problem can be solved that will produce inflation. "Russell," the gold-philes object, "how about the government monetizing the debt? How about the Fed buying all the bonds that come out?" I'll say it again: if the bond market even suspects that the Fed is heading for the inflation window, it's going to swoon, and I mean collapse. That would produce sky-high interest rates and wipe out billions of dollars worth of mortgage and bond values. Thus, at this point in the debt picture, inflation breeds deflation—and fast. And that, I suspect, is the dilemma facing gold.

Two other considerations affect gold and the precious metals. The first is the balance-of-payments hemorrhage that is now hitting this nation. At the current rate, the 1984-85 BOP deficit is going far over $100 billion. That kind of action puts pressure on the dollar, since the last thing this nation needs is a dollar run (particularly since foreigners own roughly 15% of the US debt). One way to keep the money here is via high interest rates, but high rates are basically deflationary.

A second consideration is the shaky picture of the oil price. Almost all commodities have come down substantially from their highs – lumber, beans, gold, silver, farm land, etc. But oil is still near its highs of a few years ago. Mid-East oil costs roughly 50cents to $3 a barrel to produce. So there is a lot of air under the current $29 price! The threat of further substantial deflation in "black gold" hangs over the price of yellow gold. With the current huge over-supply of oil, it's a fair bet that oil prices have further to go on the downside.



LATE NOTES: When the Averages disagree, the market is saying "uncertainty." And that's what we have (chart page 1) as the Industrials finally better their August high – but this time Transports don't confirm. Meanwhile, the PTI remains bullish – but precariously so, as it hovers 12 points above its 21-week moving average. Politically, the market wonders whether Washington hs the guts to do anything about those deficits (interest rate expenses ALONE are rising roughly $20 billion a year!).

NEXT MAILING: Nov. 28